OVEMBER 1954

business review

ERAL RESERVE

K OF

ADELPHIA

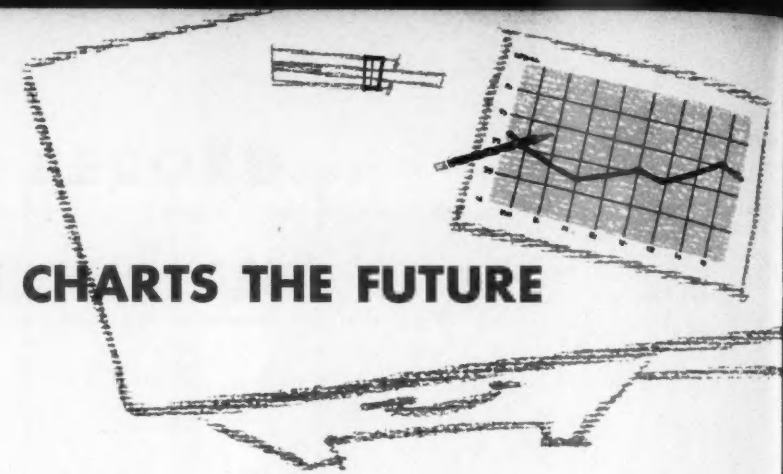
INDUSTRY CHARTS THE FUTURE

A report on our latest survey of—

1. *Capital expenditures planned for 1955*
2. *Inventory spending for the next few months*
3. *Employment prospects through next March*

THE BRANCH AND MERGER MOVEMENT IN THE THIRD FEDERAL RESERVE DISTRICT

This article, third in a series, discusses the question "How?" including legal aspects and terms of mergers.



INDUSTRY CHARTS THE FUTURE

CAPITAL EXPENDITURE PLANS

Manufacturers in the Philadelphia metropolitan area tell us they are planning to spend $257 million for new equipment and construction during 1955. In the year ended September 1, 1954, outlays amounted to $323 million. The 20 per cent cutback seems to indicate that the huge post-war program of expansion and modernization is over the hill in this region, which is the heart of the highly industrialized Third Federal Reserve District.

This report, based upon a special survey, shows that practically all industries will be making smaller capital outlays in 1955 than in the fiscal year ended last September. Producers of durable goods, as a class, plan reductions of 10 per cent for next year, and producers of nondurables expect to reduce capital outlays 26 per cent.

Precisely how much less or more the various industries plan to spend next year in contrast with capital outlays during the past year is shown, percentage-wise, in the accompanying chart. The range varies from minus 54 per cent for concerns that make transportation equipment to plus 20 per cent for the food and tobacco group. Actually, the range is still greater. Not shown in the chart is the 173 per cent increase for instruments and miscellaneous durables, which would have run right up through the roof of the chart and off the page. A mere 1 per cent increase projected by the producers of non-electrical machinery just barely got into the plus category. With these exceptions, the list turns definitely downward.

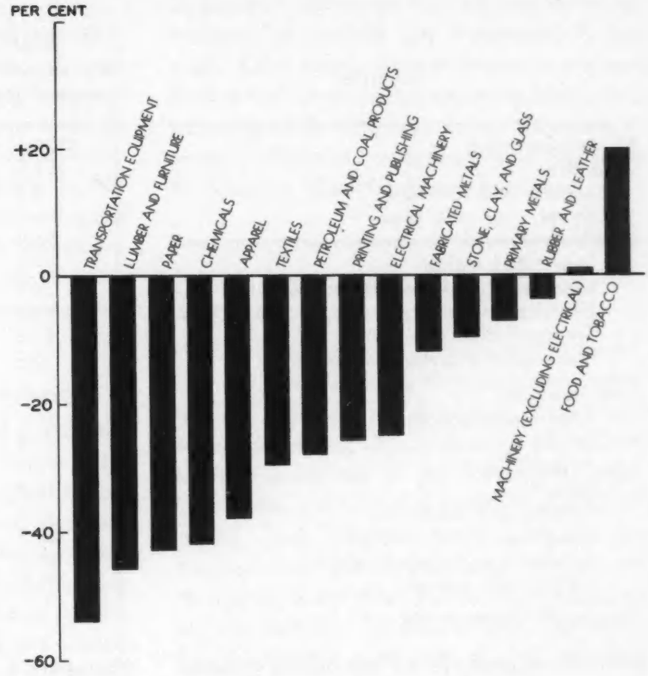
For the benefit of readers interested in dollars as well as percentages, we include the accompanying table of details. The petroleum industry, with its big refineries along the local rivers, is planning to spend the largest chunk of capital for new plant and equipment—as it did during the past year. In touring a modern refinery, it is readily apparent why it takes so much capital to squeeze so many kinds of marketable molecules out of crude petroleum. You don't see many people around the plant but what a mass of stacks and stills, pipes, pumps, gauges, tanks and towers! The heat and high pressure required to digest the crude oil is hard on the digestive system, so the equipment doesn't last long. Moreover, if wear and tear does not shorten the life of the equipment, obsolescence will. The engineers are always dreaming up new types of stills to break up the molecules and rearrange them

so that the industry can meet changing market requirements for gasoline, fuel oil, and all the other derivatives. For example, the newspapers recently reported that one of the big oil companies is building a $9 million plant next year to produce anhydrous ammonia, a fertilizer and soil conditioner, in ever-increasing demand by farmers. The $64 million being spent by all the refiners of the area next year, however, is 28 per cent below last year's outlays.

Food and tobacco companies rank second in the amount of money they plan to invest next year. The $30 million budgeted represents a 20 per cent increase over last year's outlays. The chemical industry, which has invested huge sums of money for plant modernization and expansion in recent years, rates third in the amount budgeted for next year. Nevertheless, the $29 million represents a 42 per cent decline from last year's investment.

Among the industries that are making the smallest dollar outlays for new plant and equipment are lumber and furniture, apparel, and rubber and leather. Outlays planned by each of these industries do not exceed $5 million.

CHANGES IN CAPITAL EXPENDITURES 1955 COMPARED WITH 1954



Plant or equipment

Of the new capital to be invested next year, 45 per cent is to go into plant and 55 per cent into new machinery and equipment. This is the same pattern that prevailed in last year's outlays.

In contrast with the all-industry 45-55 ratio for plant and equipment, respectively, manufacturers of durables plan to put 30 per cent of their investment in plant additions and 70 per cent in new equipment—just as they did last year. As for nondurables, however, producers plan to put 55 per cent in new plant and 45 per cent in new equipment—just as they did last year. The relatively greater proportion of new money going into equipment rather than plant on the part of the manufacturers of durables could easily be rationalized on the grounds of a faster-changing technology, but the evidence is by no means clear cut.

ESTIMATED CAPITAL EXPENDITURES IN THE PHILADELPHIA METROPOLITAN AREA

(Millions of dollars)

Industries	Total actual expenditures*	Anticipated expenditures calendar year 1955	Per cent change
All manufacturing	$322.6	$257.3	− 20%
Durables	112.9	101.2	− 10
Lumber and furniture	5.4	2.9	− 46
Stone, clay, and glass	6.1	5.5	− 10
Primary metals	26.9	25.0	− 7
Fabricated metals	19.9	17.5	− 12
Machinery (excluding electrical)	18.9	19.0	+ 1
Electrical machinery	19.6	13.7	− 30
Transportation equipment	11.6	5.3	− 54
Instruments and miscellaneous	4.5	12.3	+173
Nondurables	209.7	156.1	− 26
Food and tobacco	25.0	29.9	+ 20
Textiles	13.0	9.1	− 30
Apparel	6.5	4.0	− 38
Paper	11.8	6.7	− 43
Printing and publishing	11.0	9.8	− 11
Chemicals	48.9	28.6	− 42
Petroleum and coal products	89.0	63.7	− 28
Rubber and leather	4.5	4.3	− 4

*September 1953 - September 1954

Re-styling of products like automobiles or household refrigerators takes a lot of money for new machine tools, dies, jigs, and fixtures. Similarly, it takes a lot of money to keep up to date with the latest equipment in the primary metals, metal fabricating, transportation equipment, and electrical industries.

Is the forecast sure?

The only way to answer the question, "Is the forecast sure?" is to cite the relation between year-ahead projections and actual expenditures in our previous surveys. The revised estimates of the survey taken in September 1953 showed a prospective increase of 17 per cent for the year ending September 1, 1954. Our latest survey shows that actual expenditures turned out to be an increase of 12 per cent. Thus manufacturers last year over-estimated the increase by 4 per cent. The year before they under-estimated by 10 per cent.

Going back to earlier surveys when the area of coverage was confined to the city of Philadelphia, excluding the seven-county surrounding area, the mark was also missed by similar margins. In 1948 Philadelphia manufacturers actually spent 6 per cent less than they had estimated the year before. In each of the succeeding three years, they under-estimated their capital outlays; in 1949 they spent 2 per cent more than they had estimated the year before; in 1950, 12 per cent more; and in 1951,

15 per cent more. In every instance, however, the direction of the change was correctly anticipated. It remains to be seen how the estimated 20 per cent decline for 1955 will turn out.

Expenditures in 1955 may very well turn out to be greater than the amount indicated. In past surveys, manufacturers have usually over-estimated the declines and under-estimated the increases. Another reason why next year's decline may turn out to be an over-estimate is that in the latest survey we are really extending the forecasts four months further into the future. Actual expenditures are compared for the year ending September 1, 1954 with contemplated outlays for the calendar year of 1955.

An interpretation of the forecast

One thing that should be kept in mind in determining the prospective decline for next year is that it is based upon the peak 1953-54 capital outlay. Capital outlays by Philadelphia-area manufacturers rose successively during the past three years. Capital expenditures, like other business phenomena, come in surges and it would not be realistic to expect every year to establish a new record. For all manufacturing industries of the United States, the peak of capital expenditures on a seasonally adjusted annual basis occurred in the first quarter of 1953.

Many people have been amazed and confounded by the huge amounts of money invested in capital goods each year throughout the whole post-war period. As new records were established year after year, some observers felt all the more certain that something in the nature of a collapse was inevitable. The need for modernization and replacement of productive facilities, however, is always with us. Many of our post-war installations of equipment are already growing old or obsolete; the stock of capital goods is constantly growing and that calls for an ever-growing volume of replacements. Although we seem to be heading downward from the peak of last year, there will be plenty of inducement for continued capital investment, particularly for equipment, if not plant. Chief among these inducements are continuing high levels of income, rising labor costs, technological developments, and an abundance of money available on favorable terms that facilitates the financing of new-equipment purchases.

CAPITAL OUTLAYS OF UTILITIES AND RAILWAYS

Prospective expenditures on equipment by the utilities and railroads in the Philadelphia metropolitan area show virtually no change. In the year ending September 1954, they spent $122 million on their properties in the Philadelphia eight-county area, and in 1955 they plan to spend $121 million. These industries, supplying power, gas, transportation, and communication services, by the very nature of their business, must look ahead and plan ahead for five years at least. The monies they spend are a good index of what they think about the future of the area they serve.

INVENTORIES— MORE OF THE SAME?

No major part of spending changes direction faster or oftener than inventory investment. Since the Korean outbreak, inventory investment has varied from plus $16 billion to minus $4 billion at an annual rate. The very violence of these changes focuses attention on inventory policies.

Recently, inventory liquidation has occupied the center of the statistical stage. The working off of stocks has accounted for about two-thirds of the

net decline in gross national product that has taken place in the past year. For about six months now the mere fact that inventory liquidation has not increased removes a brake from business activity. The question now is, when will business begin to rebuild its stocks? Or, to put it another way, when will inventory spending act as a positive force in recovery?

To secure information on this subject, the Bank asked manufacturers in the Philadelphia metropolitan area about their inventory plans for the next three months. The principal conclusions from our survey are summarized below:

1. By far the largest number of firms expect no change in inventory spending over the next few months, seasonal considerations aside. But about three times as many firms that expect a change intend to decrease their inventories as intend to increase them.
2. Larger firms, particularly among durable goods producers, show a greater tendency to forecast decreases.
3. The most frequent comment made by firms cutting stocks has to do with lower sales volume.

More downs than ups

Of the firms surveyed, a large majority—about 79 per cent—said that they were planning to maintain inventories at present levels. Nearly 5 per cent of the manufacturers foresaw an increase in their stocks and about 16 per cent said that they would reduce inventories over the next few months. Seasonal influences have been removed from the projections.

Although nearly four out of five manufacturers forecast no change in inventories, this does not necessarily mean inventory levels will stay the same. In the first place, our experience with this survey last year indicated that many of those projecting no change were actually adopting a "wait-and-see" policy. About twice as many firms actually changed their inventory positions in the fourth quarter of 1953 as forecast they would. Secondly, three out of four manufacturers who predict a movement in their stocks this year say it will be downward.

Many large durable goods firms are liquidating stocks

Large manufacturers producing durable goods make up the bulk of the firms who intend to continue to draw down stocks. About 23 per cent of the durable goods makers who hold 49 per cent of the value of current inventories of hard goods are going to cut down. This compares with 6 per cent of the manufacturers of durables holding 9 per cent of current inventories who are going to step up their buying.

In nondurables, the picture is a little different. Only 11 per cent of the firms are predicting reduction of inventories and these hold just 5 per cent of the value of current stocks of soft goods. Four per cent of the nondurables manufacturers who hold 7 per cent of the inventory, say they are going to add to stocks.

Roughly one-third of the firms who said they were going to increase or decrease their inventory buying said the change would be substantial. In the main, these were small firms. Very few large manufacturers indicated a major change in their inventory plans.

Plans vary widely among industries

As the table shows, not all the industrial classifications plan to behave in the same or even in a similar manner. Three classifications in the nondurables group have no firms in our survey that

PERCENTAGE DISTRIBUTION OF MANUFACTURERS' SHORT-RUN INVENTORY PLANS

Industries	No change	Increase	Decrease
All manufacturing	79	5	16
Durables	71	6	23
Lumber and furniture	84	8	8
Stone, clay, and glass	91	9	..
Primary metals	65	12	23
Fabricated metals	74	2	24
Machinery (excluding electrical)	75	5	20
Electrical machinery	54	8	38
Transportation equipment	61	8	31
Instruments and miscellaneous	71	4	25
Nondurables	85	4	11
Food and tobacco	95	5	..
Textiles	78	3	19
Apparel	84	..	16
Paper	79	..	21
Printing and publishing	96	4	..
Chemicals	80	16	4
Petroleum and coal products	100	..	..
Rubber and leather	93	..	7

plan a cutback in inventory investment. On the other hand, in four classifications no firms plan a rise in stocks.

Two industries, classified under durables, have more than 30 per cent of firms planning to draw down inventories. Electrical machinery and transportation equipment are the industries in which the largest proportion of firms plan some decrease in inventories. Most pessimistic among nondurables are those firms making paper products and textiles and apparel.

Projected future sales determine policies

Inventory policy usually reflects manufacturers' appraisal of future sales. If firms foresee a larger market for their product, they stock up. If demand seems to be shrinking, they draw on inventories. Nine out of ten firms that plan to decrease or increase inventories give future sales volume as a reason. It is somewhat paradoxical that their actions will help to determine business levels as well as reflect their estimates of these levels. When the rate of inventory investment rises it gives the economy a boost, as does investment in plant and equipment. The level of business activity tends to be drawn down when inventory investment declines or there is liquidation.

Conclusion

If this article has a familiar ring to it, there is good reason. The consensus this year is remarkably similar to our findings last year, yet somewhat more optimistic. More firms indicate a neutral position this year, and the ratio of downs and ups is three to one as compared with four to one a year ago. The business environment in which these projections were made was strikingly different. Last year's survey was conducted before the various indexes of business activity had recorded much downward movement. Inventory accumulation had been the order of the day for about three years. The latest survey comes after a year during which business activity inched downward, partly because of liquidation of inventory. Among the firms surveyed, for example, total inventory on hand was down 4 per cent from the level a year ago.

This change in environment could cause some to put a different interpretation on the similar results. Some might reason, for instance, that the projected decline in inventories this year has less significance than it did a year ago. They would say that since we are all influenced by our environment it is only natural to find more downs than ups this year; whereas in 1953 it was unnatural. Others might reason, as we do, that inventory liquidation in this area will probably persist through the fourth quarter of 1954.

EMPLOYMENT PROSPECTS ARE APPRAISED

Manufacturers in the Philadelphia industrial area expect only small changes in their manpower requirements during the six months ending March 1955. Thus, insofar as employment is concerned, they appear to feel that the period of readjustment is about over. Total factory employment is expected to decrease fractionally, with the reduction coming during the current quarter. Durable goods producers expect to be affected very little more than those making nondurables. Employers in both major divisions of manufacturing believe their manpower needs will at least stabilize in the first quarter of next year—a little below the September 1954 level of 551,900.

This outlook for local employment is based on estimates received by the Federal Reserve Bank of Philadelphia from nearly 500 firms that participated in our current survey of capital spending plans, inventory policies, and manpower requirements. These concerns employ slightly more than half the personnel engaged in manufacturing activity in the eight-county industrial area of which Philadelphia is the nucleus.

The past year's decline was sharper than predicted

From September 1953 to September 1954, factory employment in this area showed a net decline of 62,000 or about 10 per cent. Most of the reduction came in the six months ended last March. And it was much more pronounced than had been predicted by the manufacturers responding to our previous annual survey. Over the twelve months, just about twice as many workers lost their jobs in durable goods industries as in nondurables. Transportation equipment was hardest hit, but substantial declines also occurred in the machinery and metal-working trades. In the case of nondurables, the textile and apparel lines accounted for the greatest number of jobs lost.

. . . but there has been some recovery since June

The downward trend in total manufacturing employment persisted through June, but in succeeding months of the third quarter, manufacturers in both heavy and light industry lines made small additions to their working forces. The September increase was the most pronounced and accounted for nearly half of the persons added to factory payrolls in this latest three-month period. The results of the survey we have just completed provide additional evidence that manufacturing employment in this area may be stabilizing.

Forecasts indicate the changes will be small

Nearly 45 per cent of the reporting firms estimate that manpower requirements by next March will be about what they were in September 1954. Approximately one-third expect increases. For individual lines, gains range from a fraction to just under 3 per cent. The proportion anticipating such a rise over the six-month period is somewhat greater among firms producing durable goods than those making nondurables. The remaining 23 per cent of our sample look for small declines in working forces. The most pronounced for any line does not exceed 4 per cent. This trend is forecast by about one-fifth of the durable goods manufacturers and one-fourth of those producing nondurables. Thus, even among individual lines, anticipated changes in manpower needs are quite narrow over the whole period to March 1955.

. . . in durable goods

Heavy industry lines like primary and fabricated metals, electrical machinery, and lumber and furniture expect to be employing a few more workers by next March than they were in September. In fabricated metals and lumber and furniture, anticipated gains—timed for the first quarter of 1955—will more than offset such reductions as appear likely during the current three months. Primary metal and electrical machinery producers plan small employment increases this quarter and slightly larger ones after the turn of the year.

Other durable goods producers such as those making transportation equipment, non-electrical machinery, and miscellaneous goods look for some reductions in their manpower needs in both quarters. On the basis of the number of employees involved, the most significant decrease may be in transportation equipment. Largely because of this, employment in heavy industry as a whole may show a net decline of around 1,200 workers by March 1955.

. . . and in nondurables

Expected employment changes in nondurable goods lines also are small. Textile manufacturers are the most optimistic. They expect increases in both the December and March quarters. In petroleum and coal products, small additions to working forces may be completed by the year-end but employment is expected to hold steady thereafter through March. Producers of chemicals and those making rubber and leather products see their expected fourth-quarter losses more than made up by the higher labor requirements in prospect after the turn of the year.

ESTIMATED EMPLOYMENT—PHILADELPHIA METROPOLITAN AREA

(In Thousands)

Industries	September 1954 (actual)	December 1954	March 1955
All manufacturing	551.9	548.9	549.4
Durable goods	267.8	266.0	266.6
Lumber and furniture	9.8	9.6	10.0
Stone, clay and glass	12.4	12.4	12.4
Primary metals	34.3	34.5	34.8
Fabricated metals	39.9	39.5	40.7
Machinery (except electrical)	44.3	44.0	43.9
Electrical machinery	54.4	54.5	54.9
Transportation equipment	46.0	45.1	44.3
Instruments and miscellaneous	26.7	26.4	25.6
Nondurable goods	284.1	282.9	282.8
Food and tobacco	54.8	54.3	54.0
Textiles	47.7	48.7	49.0
Apparel	56.4	55.9	55.2
Paper	21.9	21.7	21.7
Printing and publishing	33.8	33.7	32.5
Chemicals	31.2	30.5	31.8
Petroleum and coal products	22.2	22.3	22.3
Rubber and leather	16.1	15.8	16.3

Apparel, printing and publishing, and food and tobacco are nondurable lines in which employment decreases are anticipated this quarter and next. Paper manufacturers, too, look for a slightly lower level of employment in March than prevailed in September 1954, but here the adjustment is not expected to carry over into 1955. As was the case in durables, the declines forecast exceed the increases by a narrow margin, so nondurable goods manufacturers as a whole may have about 1,300 fewer workers next March than were on the payrolls when they reported to us in September.

The accompanying table compares actual employment in September 1954 with the projections for two subsequent quarters based on replies received in our current survey.

THE BRANCH AND MERGER MOVEMENT

in the Third Federal Reserve District

This is the third in a series of articles analyzing changes in the banking structure in the Third Federal Reserve District from the end of 1946 to the middle of this year. The first article, published in our August Business Review, *sketched the general background. The second, published in September, described some basic facts about the branch and merger movement in an attempt to answer four questions: How much? When? Where? Who? This article deals with the single question: How?*

PART III: THE "HOW" OF BRANCHES AND MERGERS

Any banker who has gone through a merger or has established a branch knows how much time and effort go into negotiating with the other bank and complying with legal and administrative requirements. The main purpose of this article is to show how legal provisions and patterns of procedure have shaped the branch and merger movement and at the same time reflect basic forces underlying it.

What the law says . . .

The table on pages 12 and 13 summarizes the major provisions of law applying to mergers and branches. As the footnote is careful to point out, the table attempts to give only the essence of these provisions. Anyone interested in exact terminology should look up the statutes.

. . . about mergers. But before going into specific provisions, we should define more carefully the terms we have been using. At the outset of the first article in this series we decided to use the term "merger" to cover any combination of banks coming under the heading of merger, consolidation, purchase, or absorption. The reason was to avoid confusion. When we come to questions of procedure, however, differences among these terms have more significance.

In corporation finance generally, a consolidation is not the same as a merger. When corporations A and B get together, decide to retire the stock they both have outstanding, issue new stock,

and operate under a new charter—we have a *consolidation.* When they decide to retire the stock of corporation B, issue stock of corporation A to shareholders of B, and continue to do business under A's charter—we have a *merger.* If you look through the banking laws, however—at least the laws applying to banks in the Third District—you will not find a clear distinction made. For practical purposes, bank mergers and consolidations are the same thing. Moreover, the distinction is not important so far as this study is concerned because there have been no "consolidations" in the sense used in corporation finance.

But, technically speaking, we should not use the term "merger" to mean a *purchase.* Under the law, they are different things. Usually when bank A purchases bank B it assumes B's deposit liabilities and takes over an equivalent amount of B's assets. The cash and proceeds from the sale of any remaining assets are distributed among B's stockholders. In a merger, the corporate existence of the absorbed bank is merged into and continues in the combined bank, and all rights, property, and obligations of the separate banks become those of the surviving institution. In a purchase, Bank B as a corporate entity becomes extinct; B's shareholders then pass out of the picture. Because of these legal differences, our table on the laws applies only to mergers and consolidations. But in the rest of this study, unless we are specifically referring to points of law, we are still likely to include purchases under the term "merger."

Many people use the term *absorption*—as we have used it here—rather loosely to mean simply one bank taking over another, whether by consolidation, merger, or purchase. It is not generally found in the laws on bank combinations. When banks are of substantially different size there is seldom much question about who is absorbing whom; when two banks of about the same size combine, we have simply considered the absorbing bank, for purposes of this study, to be the bank under whose charter the combined bank is to operate.

So much for terminology. It all boils down to the conclusion that while no significant distinction exists between a consolidation and merger in practice, the law regards a merger and a purchase as different things.

This legal difference has affected the pattern of bank combinations. Nowadays, as the table indicates, merger procedure is basically the same regardless of which statutes a bank must follow. This was not always so. Until 1950, a national bank could be merged into another national bank but could not be merged into a state bank; it had to sell its assets and go into liquidation. Congress changed this in 1950 by passing a bill known popularly as the "two-way street" law which, among other things, has made possible mergers between state and national banks under the charter of either.

From the beginning of 1946 to mid-1954 there were 66 instances in the Third District in which banks combined. Twenty-eight or about two-fifths of these were purchases. Looking back, there has been a definite trend over the seven and a half years away from purchases and toward mergers. Three-fourths of the cases before the "two-way street" law were purchases. The only mergers were of national banks into national banks and state banks into state banks. Since the law was passed, however, only a little more than one-third of the combinations have been by purchase. Not only did the change in law make possible a number of mergers between state and national banks, but national and state banks in combining with *other* national and state banks have both used mergers more frequently (and purchases less frequently). Over the seven-and-a-half-year period as a whole,

WHAT THE LAW SAYS ABOUT MERGERS AND BRANCHES

	Pennsylvania (7 P. S. § 819)	New Jersey (17 N. J. S. A. § 9A)	Delaware (5 Del. Code 1953)	National banks (12 U. S. C. A.)
MERGERS (See below for provisions when branches are involved.)				
1. General merger procedure	Boards of directors of each bank must approve joint plan of merger. Plan is submitted to supervisory authorities for approval. If authorities approve, plan is submitted to stockholders, giving appropriate notice. Stockholders must approve agreement. (§ 1401 to 1412)	(§ 132 to 148)	(§ 750, 751, 781 to 791)	(§ 33; 34; 34a, b & c)
2. Supervisory approval required	Department of Banking (Also, Banking Board if branch is involved.) (§ 1401 et seq.)	Banking Commissioner (§ 133 et seq.)	Board of Bank Incorporation and Bank Commissioner (§ 750, 784)	Comptroller of Currency. (§ 33, 34a, 34b)
	Board of Governors of the Federal Reserve System reviews proposed merger if surviving bank is a state member bank, and in some cases its approval may be required. Federal Deposit Insurance Corporation has similar power with respect to insured non-member state banks.			
BRANCHES				
1. Procedure in establishing branch	Apply to supervisory authority; must amend charter (§ 204, 303)	Apply to supervisory authority; need not amend charter (§ 3, 20)	Apply to supervisory authority; need not amend charter (§ 770)	Apply to supervisory authority; need not amend charter (§ 36)
2. Supervisory approval required	Dept. of Banking and Banking Board; decision of Board is binding on the Department (§ 204)	Banking Commissioner (§ 20)	Board of Bank Incorporation and Bank Commissioner (§ 770)	Comptroller of Currency. If branch is acquired by merger and was established before Feb. 25, 1927, no approval necessary; if established after that date, must be approved the same as a new branch. (§ 36(b), 36(c))
	Board of Governors of the Federal Reserve System must approve branches of state member banks. Federal Deposit Insurance Corporation must approve branches of state non-member insured banks.			
limitations				

Federal Deposit Insurance Corporation must approve branches of state non-member insured banks.

limitations				
(a) Within head-office city	Permitted (§ 204D)	Permitted (§ 19)	Permitted (§ 770)	New branches subject to same limitations as apply to state banks (§ 36(c))
(b) Outside head-office city, but in same county	Permitted (§ 204D)	Branches permitted only if: (1) acquired by merger; (2) at location of liquidating banks or branches; (3) new branch is established in community with no bank or branch (§ 19B)	Permitted (§ 770)	Same as 3(a)
(c) Outside county	Limited to contiguous counties (§ 204D) Dept. of Banking may disapprove if a bank in that county has notified Dept. of intention to establish a branch in the same community (§ 204 F(2))	Not permitted (§ 19B)	Permitted (§ 770)	Same as 3(a)
4. Criteria for approval	Community must be without adequate banking facilities (except in city of first or second class) (§ 204D, 204F(2))	In case of new branches only: Interests of the public must be served to advantage; locality must afford reasonable promise of successful operation (§ 20)	Bank must be authorized by charter to establish branches Public convenience must be served; must be good and sufficient reason for establishment (§ 770)	Same criteria as apply to state banks in state concerned (§ 36(c))
5. Capital requirements				
(a) In head-office city	No additional required (§ 204E)	Amount required for head office plus the lesser of $100,000 for each branch or amount required for a new bank at location of each branch (§ 19C)	$25,000 capital and $25,000 surplus for each place of business (§ 770)	No additional required unless required by state (§ 36(c))
(b) Outside head-office city	Capital and surplus must be that for head office plus amount required for a new bank at location of each branch (except requirement is only 50% in community of 5,000 or less) (§ 204E)	Same as 5(a)	Same as 5(a)	The greater of either: (1) capital and surplus required by state, or (2) capital and surplus required to establish a new national bank at location of each branch (§ 36(c) and (d))

Note: This table is intended to give the essence, but not necessarily the exact legal terminology, of the major provisions affecting mergers and branches. Anyone interested in exact terminology should consult the statutes; references are cited in parentheses.

as the following table shows, national banks have used purchases decidedly more than have state banks.

	Purchase	Merger	Total
National banks absorb national banks	57%	43%	100%
National banks absorb state banks	50	50	100
State banks absorb state banks	29	71	100
State banks absorb national banks	25	75	100
All combinations	42%	58%	100%

Banks give legal aspects less weight than other considerations in deciding whether to merge with a bank or purchase it. Usually, among the first matters to come up is taxes. In a merger, stockholders of the *absorbed* bank do not have to pay capital gains taxes on the new shares issued in exchange for old; in a purchase, they may have to pay capital gains taxes on cash that they get for their shares. In most cases, stockholders don't want cash; they would rather continue as owners of the surviving bank, particularly since they usually get a better return than they have been getting. In short, stockholders of the absorbed bank have tended to favor a merger over a purchase. In many cases, of course, this may be overcome by making the purchase price sufficiently attractive.

On the other hand, if capital is relatively large, it may be in the interests of stockholders of the *absorbing* bank to favor a purchase because there is no increase in stock outstanding. Management of the absorbing bank also prefers to purchase rather than merge because bankers consider a purchase a "cleaner" transaction. Once the deal goes through it is over and done with. Usually, personnel of the purchased bank are taken on by the purchasing bank, but since the stockholders are paid off in cash they do not become stockholders of the purchasing bank. When assets are acquired without increasing capital, the capital cushion becomes thinner, and this may require action by the authorities; but in most instances it simply means higher earnings on the same capital base.

A look at the record to see which banks merge and which ones purchase suggests some other considerations that may reflect such non-economic factors as personal prestige and local pride. The pattern is far from clear-cut, but when two banks of about the same size—whether large or small—or when two banks in the same town decide to get together, they are more likely to merge. A purchase is more likely when one bank takes over a considerably smaller bank or when the banks are in different towns. The major exception is when Philadelphia banks are involved. The large Philadelphia banks have used mergers almost exclusively, even when absorbing small banks. Perhaps stockholders of banks in and around the city are more sensitive to tax considerations, and perhaps management gives more consideration to some of the non-economic factors suggested above.

. . . about branches. Compared with mergers, the laws on branches are more complicated and take up more space in the table. One aspect of the law which bankers are necessarily interested in is the relationship among the various supervisory authorities. Although this may look complicated, actually it comes down to one simple principle—an attempt to keep national and state banks on a par competitively. Thus, in general the legal powers given national banks are integrated with those granted to state banks. The Federal Reserve and Federal Deposit Insurance Corporation follow the same principle in their areas of responsibility.

Probably the most interesting provisions—and certainly the most controversial — are the geographical limitations on branch banking. As the table indicates, Delaware laws are the most liberal of the three states; branches can be established

anywhere in the state. Pennsylvania is more restrictive, limiting branch banking to contiguous counties. And New Jersey is most restrictive, limiting branches to the same county as the head office.

The provisions of law in the respective states are not so clear-cut as this, however. For example, in Pennsylvania they require the supervisory authorities to determine whether banking facilities are adequate and to give preference to banks in a given county over banks in contiguous counties. This is the law, and recently in Pennsylvania the law has been reaffirmed by the Supreme Court. Some bankers feel that the law should be changed, but are not agreed on *how* it should be changed. This article has to do only with the law as it stands, and what has happened under that law.

Terms of mergers and purchases

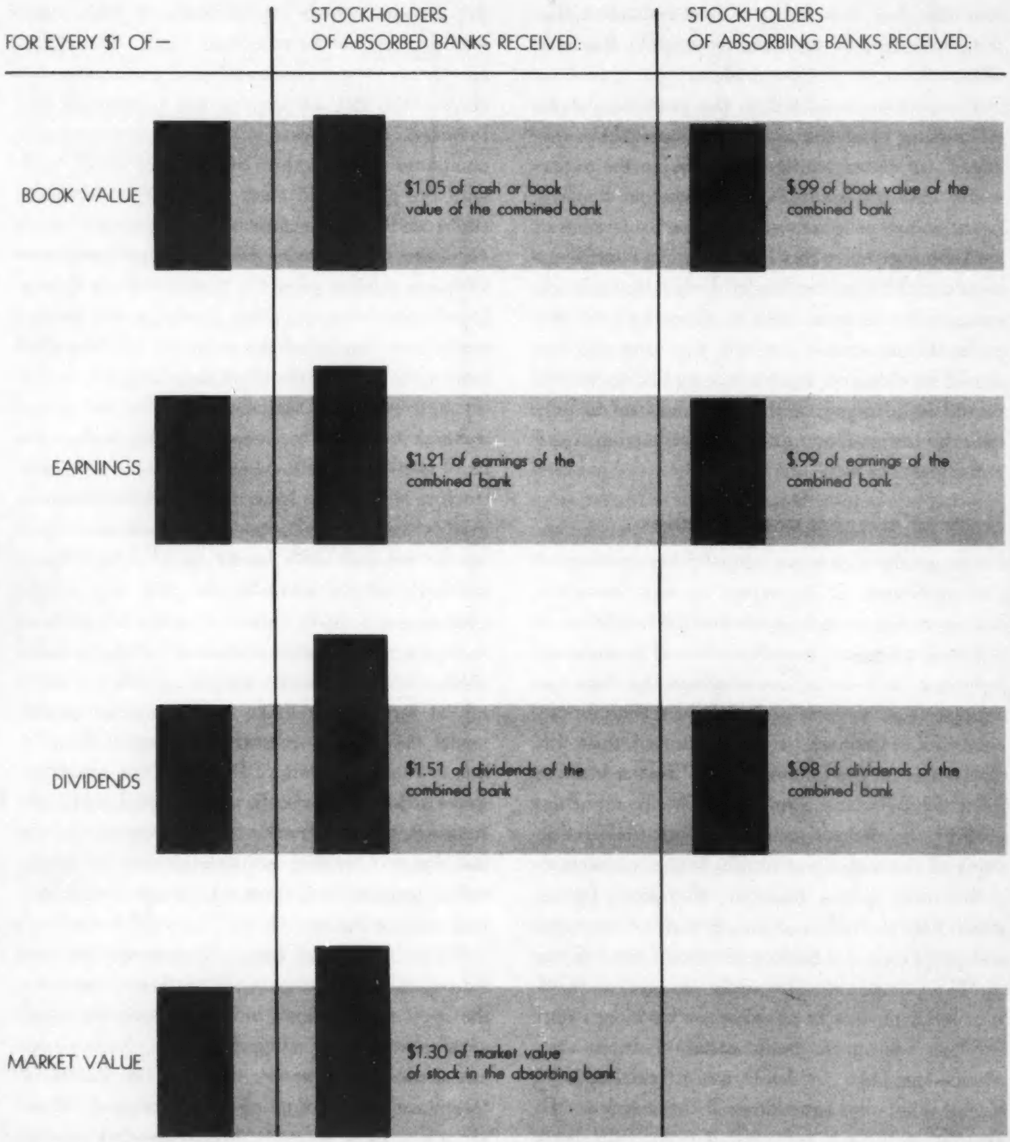
Banks go through many steps either in mergers and purchases, or in setting up new branches. But in mergers and purchases the situation is different from the establishment of branches—representatives of two or more banks must get together and negotiate the terms. Where they come out, of course, is a vital dollars-and-cents matter to everybody concerned. From a broader point of view, the terms are a very important part of the merger movement, for they reflect many of the motives of parties to the transaction.

We have gotten together, therefore, figures which help to give some idea of terms of mergers and purchases and have summarized them in the chart on page 16. In order to get as well-rounded a picture as possible, we have used four different measures: book value of capital accounts, earnings, dividends, and market value of stock. What we have done is to compute the amount each bank *contributed toward* the book value, earnings, and dividends of the combined bank. Then, by using the terms, we computed the amount which stockholders of each bank would *get from* the combined bank. The difference between amount contributed and amount received indicates whether or not a premium was involved. In the case of purchases, we simply compared book value of the absorbed bank with the amount of cash which its stockholders received. And in the case of market value of stock (because market price for one bank cannot be added to market price for another to get a combined value) we adjusted prices by the merger terms and compared the stock of the absorbed bank with stock of the absorbing bank.

Book value. One measure of the value of a bank is its net worth—what's left over after subtracting liabilities from assets. Unfortunately, this is an inaccurate measure sometimes, primarily because some banks carry certain assets on their balance sheets below their true worth. Consequently, book value of capital accounts is only an approximation of the real value of a bank. Banks start with book value as a basis for arriving at terms, then make any important adjustments they think necessary to bring it more in line with actual value. Probably the most frequent adjustment is in the value of banking house, for many banks carry this asset at a conservatively low figure. Another adjustment may be in the value assigned to investments to agree with current market values.

While banks take these adjustments into consideration in arriving at terms, they do not, for the most part, actually make them on their balance sheets. As a general rule, supervisory authorities frown on write-ups, a policy that tends to reduce the amount of premium paid. If an absorbing bank wants to acquire another bank at

FOUR MEASURES OF MERGER TERMS



more than its book value, it can do so only by paying the premium through reduction of its own surplus or undivided profits rather than capitalizing the premium on its books. In the case of a merger, this will dilute the value of stock held by share holders of the absorbing bank; in a purchase it will result in an actual pay-out of cash. If the practice of paying premiums in purchases goes too far, the supervisory authorities may refuse to approve the transaction or require additional capital.

We were not able to get all the adjustments banks made in arriving at terms, so the chart shows only a comparison of book values. Nevertheless, it indicates clearly that absorbing banks paid more than book value for the banks they acquired. In the typical case, for every $1 of book value which stockholders of the *absorbed* bank gave up, they got about $1.05 in cash or book value in the combined bank. The figure was about the same for mergers as for purchases, but in many cases it would be quite different if the special adjustments were taken into account. For every $1 which stockholders of the *absorbing* bank had, they got about 99 cents in the combined bank. Usually one bank was so much larger than the other that the terms had a much greater effect on stockholders of absorbed banks than on stockholders of absorbing banks.

Earnings. Perhaps the best measure of what stockholders are giving up and what they get is net current earnings. Our figures on these (as well as dividends and market value of stock) include, of course, only mergers because when stockholders are bought out they no longer get earnings and dividends or have stock to sell. In the typical merger, stockholders of the absorbed bank gave up $1 of earnings for $1.21 of earnings in the combined bank—a premium substantially above that shown for book value. In some mergers, stockholders got less than they contributed, but in several they received over twice as much. Stockholders of the absorbing bank got 99 cents of earnings in the combined bank for every $1 they were getting before.

Dividends. Dividends, in one sense, are not so good a measure as earnings because they may be influenced by non-recurring profits and losses and the amount of profits paid out. On the other hand, they are what most stockholders are interested in. Dividends show the biggest premium of any of the four measures; typically, stockholders of absorbed banks got about $1.51 in dividends of the combined bank for every dollar in their own bank. As we pointed out in the preceding article, absorbing banks not only earn more on their capital but also pay out a relatively larger proportion of earnings than the absorbed banks.

Market price of stock. This measure is by far the least accurate, but in some ways it is the most interesting of the four. It is less accurate because bank stocks, except for stocks of the larger city banks, are usually closely held and seldom traded. If you try to get an accurate market price of the stock of a small bank, you are likely to end up with the price at which the last sale was made (which might be some time ago) or the last price bid (which might or might not be a good reflection of market value in view of the fact that probably no shares were offered for sale). We have tried to get the most accurate prices available, but add a caution not to interpret the figures too closely.

This measure is interesting because it reflects another strong reason why stockholders of absorbed banks vote for mergers. As the chart indi-

cates, stockholders of absorbed banks typically got about $1.30 in market value of stock in the absorbing bank for every $1 of their own stock. Not only did the merger give them more value in a going concern—ownership of greater book value and higher earnings and dividends per share—but it gave them a chance to sell their new stock in the market for a considerably better price than they could have gotten for their old stock. And because their new stock was usually in a considerably larger bank, it probably had a much broader market.

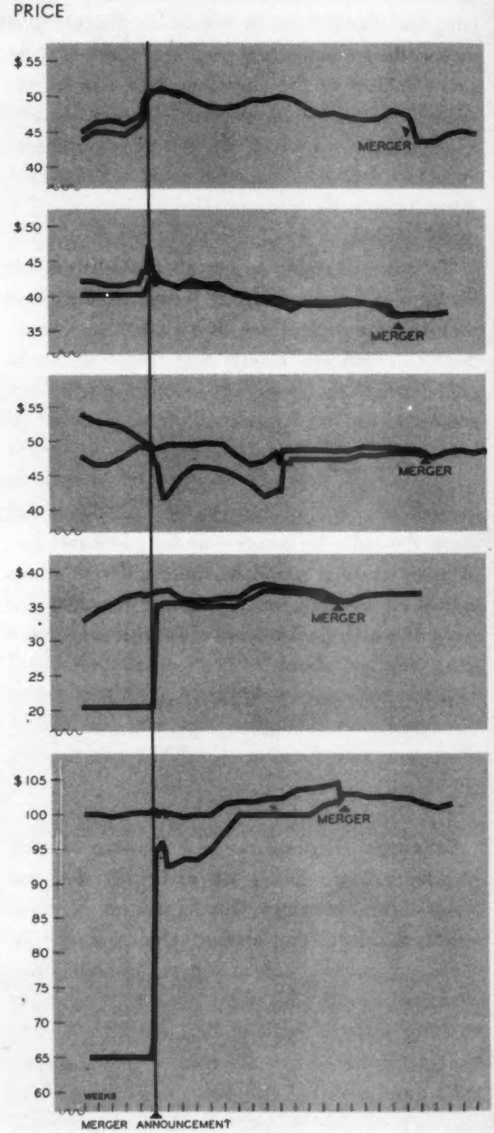
The behavior of market price is the best single indicator of what investors think of the merger. An illustration is provided by the accompanying chart. This shows how prices of ten bank stocks behaved before and after announcement of merger terms. These are stocks of Philadelphia banks whose prices were quoted daily in the financial pages of the newspapers. In order to make them comparable, we have adjusted the prices for the basis of exchange provided by the merger.

The top two panels show what happened in mergers between large banks. Before there was any talk of a merger, the price for each bank reflected pretty well what experienced dealers and investors figured the stock to be worth, using such measures as we have been discussing here. The prices for both banks (after adjustment) were nearly the same. When the merger was announced, prices spurted a little as investor interest picked up, but soon settled down and travelled along closely together.

The third panel indicates how market uncertainty is reflected in price. The stock of the absorbed banks moved up early as news leaked out to the market. It dropped because of doubt as to whether the deal would go through, but rose again when the merger was finally approved.

The fourth and fifth charts present a striking

MARKET BEHAVIOR OF SELECTED BANK STOCKS



picture of what is typical in many mergers—a sudden upward adjustment in the stock of a medium or small bank being absorbed by a large bank. Stock of the large banks was affected very little. But as soon as the merger terms were announced, dealers and investors took a hard look at the price of stock of the absorbed banks in the light of what stockholders would get when the merger went through. They immediately jumped the price up toward parity with the stock of the absorbing banks. Prices may not always adjust immediately if there is any uncertainty about the merger being approved or if a substantial number of stockholders unload their holdings below the parity price.

Prices are not available to make charts similar to these for all banks; if they were, the picture in a good many cases would look like the bottom two panels. The spurt in price is a response to the fact that stockholders are getting more for their money in the form of book value, earnings, and dividends, and are getting stock with greater marketability. In many cases it may also indicate that the stock had been under-priced.

Conclusions. Every merger is different. Terms are arrived at through negotiation and reflect the particular situation of the banks concerned. In a sense, therefore, it may be misleading to talk in the over-all, as we have here. Anyone who has followed the merger movement knows, for example, that terms agreed upon by two large city banks are likely to be quite different from those in a merger of a large city bank and a small suburban bank.

Yet, bearing these qualifications in mind, the picture seems quite clear. In the typical merger, absorbing banks have paid premiums, in some cases substantial premiums; stockholders of absorbed banks have made out well.

The next logical question is: Why? What are the motives underlying the branch and merger movement? This will be the subject of the next article in this series.

Additional copies of this issue are available

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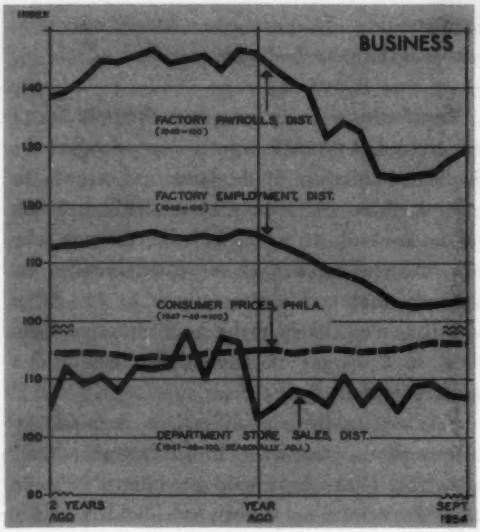
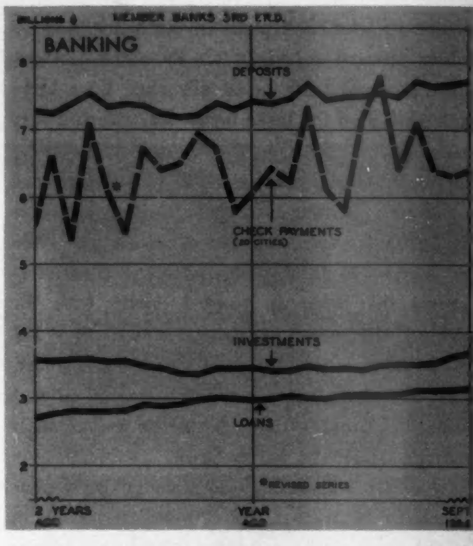
FOR THE RECORD...





SUMMARY	Third Federal Reserve District — Per cent change: September 1954 from mo. ago	September 1954 from year ago	9 mos. 1954 from year ago	United States — Per cent change: September 1954 from mo. ago	September 1954 from year ago	9 mos. 1954 from year ago
OUTPUT						
Manufacturing production	0	−13	−14	+2	− 7	− 9
Construction contracts*	+1	+38	+21	+2	+ 6	+12
Coal mining	+1	−27	−23	+1	−18	−18
EMPLOYMENT AND INCOME						
Factory employment (Total)	0	−10	− 9	+1	− 9	− 8
Factory wage income	+1	−12	−12	...	...	...
TRADE**						
Department store sales	0	+ 3	− 4	−4	+ 1	− 3
Department store stocks	+1	− 4	...	0	− 3	...
BANKING (All member banks)						
Deposits	+1	+ 8	+ 4	+1	+ 4	+ 4
Loans	+1	+ 6	+ 5	+1	+ 1	+ 2
Investments	+1	+ 5	+ 2	0	+10	+ 6
U.S. Govt. securities	+1	+ 3	0	0	+ 9	+ 6
Other	+2	+15	+ 6	+2	+11	+ 7
Check payments	+1†	+ 5†	+ 5†	−1	+ 1	+ 7
PRICES						
Wholesale	...	...	...	0	− 1	0
Consumer	0‡	+ 1‡	+ 1‡	0	0	+ 1

*Based on 3-month moving averages.
**Adjusted for seasonal variation.
†20 Cities
‡Philadelphia

LOCAL CHANGES	Factory* Employment — Per cent change Sept. 1954 from mo. ago	year ago	Factory* Payrolls — Per cent change Sept. 1954 from mo. ago	year ago	Department Store Sales — Per cent change Sept. 1954 from mo. ago	year ago	Department Store Stocks — Per cent change Sept. 1954 from mo. ago	year ago	Check Payments — Per cent change Sept. 1954 from mo. ago	year ago
Allentown	+1	−12	+3	−15	...	...	...	...	+ 8	+ 1
Harrisburg	0	−15	−3	−22	...	...	...	...	− 1	0
Lancaster	0	− 6	+4	+ 1	+13	−2	+11	+ 4	+ 6	+ 2
Philadelphia	+1	−10	+1	−10	+44	+6	+10	− 5	0	+ 6
Reading	+1	− 9	−1	−10	+35	+9	+10	− 5	− 6	− 1
Scranton	0	− 7	+1	− 7	+27	+5	+13	+ 8	+ 1	− 1
Trenton	+2	−11	+2	− 8	+28	+1	+21	− 2	−25	+ 3
Wilkes-Barre	−1	−10	−1	− 8	+22	+2	+10	−11	− 8	−11
Wilmington	+1	−10	+1	− 5	+25	+1	+11	− 1	+36	+18
York	−1	− 9	−3	−10	− 6	−5	+10	− 3	− 1	− 2

*Not restricted to corporate limits of cities but covers areas of one or more counties.